Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Computer III Further Remand	)	CC Docket No. 95-20
Proceedings: Bell Operating	)	
Company Provision of Enhanced Services	)	

REPLY COMMENTS OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

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SUMMARY OF POSITION

The comments in this proceeding demonstrate that Computer II's structural separation regime is more effective, and imposes fewer costs, than Computer III's nonstructural safeguards. Whereas the effectiveness of structural separation as a competitive safeguard has never been called into question, the record is replete with examples of anticompetitive behavior that took place notwithstanding the existence of nonstructural safeguards. The Ninth Circuit's decision in Computer III confirmed this marketplace experience when it found the Commission's nonstructural safeguards, particularly CEI and ONA, to be ineffective in guarding against access discrimination and other forms of anticompetitive abuse. The comments filed by the BOCs do not identify any changes in these safeguards that would remedy their infirmities. The Commission should therefore continue to rely on structural separation.

The BOCs contend that the Commission's price cap and accounting rules are sufficient to prevent the cross-subsidization of the BOCs' enhanced service offerings. Despite "improvements" in the Commission's accounting regulations after California I, all seven of the BOCs have been found to have recently engaged in anticompetitive cross-subsidization. Contrary to the BOCs' claims, the Commission's accounting safeguards do not prevent cross-subsidization. First, price caps perpetuate the BOCs' incentive to cross-subsidize their enhanced services because they still contain rate-of-return elements. Second, the Commission lacks the resources to conduct the extensive auditing necessary to effectively monitor the BOCs' actions.

The Commission's other nonstructural safeguards are similarly ineffective in preventing access discrimination. As many parties -- including the Ninth Circuit -- have pointed out CEI, is ineffective in deterring access discrimination because it only provides ESPs with access to the network services used by the BOCs' own enhanced service operations; it does not give competing ESPs access to the "building blocks" of the network. Without such access, ESPs cannot freely design and implement their own enhanced services. The BOCs have not identified any changes in CEI that would make it an effective competitive safeguard.

As at least one of the BOCs has candidly acknowledged, ONA does not provide ESPs with all of the unbundling they requested. The non-existent demand for ONA services among ESPs is telling evidence that the BOCs have failed to provide useful or affordable network building blocks that are attractive or valuable to ESPs. Until the Commission changes its ONA regime and requires the BOCs to unbundle their networks into the basic building blocks needed by ESPs, ONA cannot be relied upon as a safeguard against access discrimination.

Several of the BOCs argue that the Commission's actions in the Expanded Interconnection and Intelligent Networks proceedings have achieved unbundling of the network beyond ONA. The Expanded Interconnection proceeding, however, does not provide ESPs with access to the type of network services most needed to provide enhanced services. That proceeding also denied ESPs the ability to physically collocate their enhanced services equipment in the BOCs' central offices. The Intelligent Networks proceeding has not progressed beyond a Notice of Proposed Rulemaking. Even if the

proposals in that proceeding were adopted, it is unclear whether independent ESPs would be accorded the same access to databases as the BOCs' own enhanced service operations. Whatever the outcome of that proceeding, the Commission may not properly consider nonexistent rules in evaluating the efficacy of nonstructural safeguards.

The BOCs also argue that competition in the enhanced services marketplace is sufficient to prevent anticompetitive behavior. Their analysis, however, is fundamentally flawed. It is the lack of competition in local exchange markets that gives the BOCs the ability to leverage their monopolies anticompetitively in enhanced services markets. Despite their protestations to the contrary, the BOCs retain a complete stranglehold over local exchange service. As long as the BOCs retain a dominant position in the local exchange market, safeguards will be needed to prevent anticompetitive abuse in the enhanced services marketplace.

The state of competition in enhanced services markets has no bearing on the efficacy of nonstructural safeguards. Anticompetitive behavior on the part of the BOCs can cause serious harm regardless of the competitiveness of the enhanced services marketplace. Cross-subsidization can force costs on ratepayers for less efficient service offerings. Access discrimination can harm competitors and competition without resulting in the monopolization of the market. Consumers are harmed when access discrimination forces them to accept lower quality or less efficient services or delays the introduction of new services. These costs exist and burden consumers, regardless of the state of competition in the enhanced services marketplace.

The costs of the BOCs' anticompetitive behavior -- made possible by ineffective nonstructural safeguards -- far outweigh the claimed efficiencies of integration and costs of structural separation. The efficiencies cited by the BOCs, however, are illusory at best. So, too, are the costs of separate subsidiaries cited by the BOCs. The need for personnel, facilities and equipment will remain the same without regard to whether the BOCs' enhanced service operations are integrated or separate. Unless the BOCs have deliberately overstaffed and overequipped their regulated services, there should be no excess personnel, equipment, and office space for use by their enhanced service operations.

The claimed efficiencies that result from integrating the BOCs' basic and enhanced service operations are not true economies of scope. To the extent that there is "unused capacity" in the BOCs' network equipment and capacity, it is likely to be the product of unnecessary overinvestment in network equipment. Only when regulated services are improperly charged with the capital costs of this equipment can the BOCs claim "economies" for their enhanced service operations. The other claimed economy of scope, one-stop shopping, can be accomplished by means other than integration. If the BOCs were to permit full resale of their services, independent ESPs and the BOCs' separate subsidiaries could give consumers the benefits of joint marketing and one-stop shopping, without the use of integrated operations and without the attendant risk of anticompetitive behavior. The only tangible benefits which the BOCs can attribute to their integrated operations are a product of their local exchange monopoly. These benefits -- while providing value to the BOCs' shareholders -- do not benefit the public.

In comparing the costs and benefits of structural separation with nonstructural safeguards, the Commission should favor competition rather than the illusory benefits of integration. The history of anticompetitive abuse on the part of the BOCs while operating under nonstructural safeguards should convince the Commission of the need to maintain structural separation.

Finally, Bell Atlantic proposes a number of changes in the Commission's nonstructural safeguards, as well as in the definition of enhanced services. Given the ineffectiveness of these nonstructural safeguards as they currently exist, weakening them would only further harm the public interest. The Commission should therefore reject any attempt to weaken these safeguards. Bell Atlantic's proposal to exclude protocol processing from the definition of enhanced services should also be rejected. Procedurally, the Commission has not given the necessary notice to take such action. Substantively, the change proposed by Bell Atlantic has already been considered and repeatedly rejected by the Commission. The current definition of enhanced services has served the public well, and should be retained. It is well understood, easy to apply and draws a clear distinction between basic and enhanced services. Most important, it has ensured that competitive enhanced services remain free from needless Title II regulation.

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REPLY COMMENTS OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

The Information Technology Association of America ("ITAA"), by its attorneys, hereby replies to the comments that were filed in response to the Commission's Notice of Proposed Rulemaking ("Notice") in the above-captioned proceeding on April 7, 1995.[1] In its Notice, the Commission solicited comment on the most appropriate regulatory mechanism to prevent the Bell Operating Companies ("BOCs") from engaging in access discrimination and other forms of anticompetitive abuse to the detriment of competition in the enhanced services marketplace.[2] As set forth below, the comments overwhelmingly demonstrate that structural separation is the most effective and only proven means of preventing such abuse.

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[1] A list of the parties filing comments in this proceeding is attached as Appendix A. See Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services, Notice of Proposed Rulemaking, CC Docket No. 95-20, FCC 95-48 (released Feb. 21, 1995) [hereinafter "Notice"].

[2] See Notice ¶¶ 11-12.

I. INTRODUCTION

None of the parties filing comments in this proceeding -- with the exception of the BOCs -- contend that nonstructural safeguards are effective in preventing the BOCs from engaging in anticompetitive abuse in the enhanced services marketplace. Indeed, the BOCs themselves have not put up a spirited defense of nonstructural safeguards. Rather, they have chosen to focus on the competitiveness of the enhanced services marketplace, a fundamentally irrelevant point. The reason for the BOCs' diversionary tactics are clear; the record is replete with examples of anticompetitive abuse on the part of the BOCs, notwithstanding the Commission's nonstructural safeguards.

The comments thus bring into sharp focus the differences between the Commission's experience with Computer II's structural separation regime and Computer III's nonstructural safeguards. Computer II and its structural separation requirement have proven to be effective in guarding against access discrimination and cross-subsidization. Structural separation's effectiveness has never been questioned. Computer III's nonstructural safeguards, by contrast, have proven to be a dismal failure. Once the Commission retreated from fully implementing open network architecture ("ONA"), Computer III's other nonstructural safeguards were incapable of preventing access discrimination. The Ninth Circuit so found in California III, and the BOCs have not presented any significant evidence to the contrary. Nonstructural safeguards have also proven to be ineffective in preventing cross-subsidization. Since the Computer III Remand Proceeding, both the Commission and the states have found the BOCs to have engaged in significant cross-subsidization of their competitive activities, the Commission's accounting rules notwithstanding.

Because of the extensive record of anticompetitive abuse on the part of the BOCs in enhanced services markets, the conclusion is inescapable that nonstructural safeguards are not deterring anticompetitive behavior. ITAA and many other parties have pointed out the deficiencies of the Commission's comparably efficient interconnection ("CEI"), ONA, customer proprietary network information ("CPNI"), and accounting safeguards in numerous proceedings over the past ten years. The Ninth Circuit has agreed that these flaws render Computer III's nonstructural safeguards an inadequate substitute for structural separation. Surprisingly, the BOCs have largely chosen to ignore these flaws in their comments. As a consequence, there is nothing in the record which explains why these safeguards -- which have not changed since the Commission readopted them in the Computer III Remand Order -- should now be found to be effective.

As the Commission analyzes the costs and benefits of moving from a structural separation regime to nonstructural safeguards,[3] its judgment should be informed by the actions of Congress, the Department of Justice, and Judge Greene. All have chosen to rely on structural separation as the primary safeguard against anticompetitive abuse as the BOCs are permitted to enter competitive markets. The Commission should also weigh the costs of failed nonstructural safeguards against the unproven benefits of integration. Upon doing so, the Commission can come to no other conclusion than to retain the existing structural separation requirements.

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[3] The effect of the California III decision is to restore the Computer II structural separation requirements. See ITAA Comments at 12-18; MCI Comments at 7-12; CompuServe Comments at 12-15; Prodigy Comments at 2-3. Thus, the Commission is obligated to make an affirmative decision to eliminate the structural separation requirements, and explain its reasoning for doing so.

II. THE BOCS HAVE FAILED TO DEMONSTRATE THAT NONSTRUCTURAL SAFEGUARDS ARE EFFECTIVE IN PREVENTING ANTICOMPETITIVE BEHAVIOR IN THE ENHANCED SERVICES MARKETPLACE.

The Commission's decision to initiate this proceeding was prompted by the Ninth Circuit's decision in California III which, for the second time, vacated the Commission's efforts to replace structural separation with nonstructural safeguards.[4] The Ninth Circuit found that the Commission had not adequately explained its decision in light of the record evidence that nonstructural safeguards, specifically CEI and ONA, were incapable of preventing access discrimination.[5] Because the Commission had failed to address the inadequacies of ONA and CEI in its cost-benefit analysis, the Ninth Circuit vacated the Computer III order permitting the integrated offering of basic and enhanced services by the BOCs.

Now that the Commission has decided to revisit its cost-benefit analysis, it is obligated, as pointed out by MCI, to consider not only the issues raised by the Ninth Circuit, but also any other factors -- including the risk of cross-subsidization -- relevant to such an analysis.[6] Additionally, the Commission should consider its experience since Computer III, including the BOCs' lengthy record of access discrimination and cross-subsidization.[7] The

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[4] See California v. FCC, 39 F.3d 919 (9th Cir. 1994) [hereinafter "California III"], cert. denied, 115 S. Ct. 1427 (1995).

[5] California III, 39 F.3d at 929-930.

[6] See MCI Comments at 23-49.

[7] Although the Ninth Circuit did not criticize the Commission's accounting rules in California III, the Commission is obligated to consider their adequacy anew in this (continued...)

BOCs have compiled this record of anticompetitive abuses while confined to the intraLATA enhanced services market. Their incentive to engage in such abuse can only be expected to grow when the BOCs are permitted to enter interLATA markets. Only after fully considering the costs of moving from structural to nonstructural safeguards should the Commission focus on the benefits of such action.

A. The Comments Demonstrate That Nonstructural Safeguards Are Ineffective in Preventing Cross-subsidization.

Some of the BOCs contend that the Commission's price cap and accounting rules are sufficient to prevent the cross-subsidization of enhanced services by regulated basic services.[8] The BOCs, however, never address or analyze the efficacy of the Commission's accounting rules and price cap regime. They rely instead upon the Ninth Circuit's statements in California III that the Commission improved its accounting rules subsequent to California I.[9] Although the Commission did, in fact, modify its accounting procedures prior to the

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[7](...continued)
proceeding (as the Court considered ONA anew in evaluating the Commission's cost-benefit analysis). A proper cost-benefit analysis requires a weighing of all costs and benefits as they are currently known. Policies and rules that may have been thought to be adequate in the past may no longer be so in light of evidence presented subsequent to the earlier analysis.

[8] See Ameritech Comments at 11; NYNEX Comments at 10-13; Pacific and Nevada Bell Comments at 68.

[9] See California III, 39 F.3d at 926-927.

Computer III Remand Order, including the introduction of ARMIS, the comments demonstrate that these "improvements" are inadequate to prevent cross-subsidization.[10]

The Commission's price cap regime has similarly not succeeded in removing the incentive for the BOCs to cross-subsidize their enhanced services. The newly revised price cap rules still contain rate-of-return elements, and therefore still give the BOCs the incentive to transfer costs from unregulated to regulated activities.[11] MCI correctly observes that if the price cap regime had removed the incentive to cross-subsidize, then the Commission's audits would not have discovered so many violations.[12] Further, the Commission still lacks the resources to conduct the extensive auditing necessary to effectively monitor the BOCs' actions, a conclusion twice reached by the General Accounting Office.[13] When the Commission has conducted audits of the BOCs, it has found wholesale violations of its accounting rules. CompuServe notes that the Commission's difficulties in enforcing its rules have been compounded by accounting methods, such as those used by Southwestern Bell, that do not provide historical cost information.[14]

The real proof that the accounting rules have been a failure is the litany of abuse cited by the commenting parties. All seven of the BOCs and GTE have been found to

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[10] See, e.g., Ad Hoc Comments at 14-16; MCI Comments at 42-49; CompuServe Comments at 27-35; ITAA Comments at 38-43.

[11] See MCI Comments at 47; ITAA Comments at 38.

[12] MCI Comments at 47.

[13] See CompuServe Comments at 35-36; ITAA Comments at 39-41.

[14] See CompuServe Comments at 31-32.

have cross-subsidized their unregulated operations in violation of the accounting rules.[15] When evaluating the effectiveness of nonstructural safeguards, the Commission should therefore look to the experience of its auditors. With so many instances of cross-subsidization following Computer III, the Commission should conclude that its nonstructural safeguards have been ineffective in preventing anticompetitive subsidies. Structural separation, by contrast, has been effective in minimizing such conduct.

B. The Comments Demonstrate That Nonstructural Safeguards Are Ineffective in Preventing Access Discrimination.

In its Notice, the Commission catalogued the nonstructural safeguards adopted in Computer III.[16] The Notice also pointed to the Expanded Interconnection and Intelligent Networks proceedings as examples of other policies that might make access discrimination on the part of the BOCs more difficult.[17] In their comments, the BOCs have done a reasonable job describing the requirements of these safeguards and proceedings; they have failed, however, to explain away the fatal flaws of these safeguards. As many of the commenting parties have noted, the Commission's nonstructural safeguards are no more capable of preventing access discrimination now than they were before California III. The Commission

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[15] See MCI Comments at 43-45; Ad Hoc Comments at 14-15; CompuServe Comments at 27-34; ITAA Comments at 44-47. All seven BOCs were recently issued Orders to Show Cause in relation to accounting violations dating mainly from 1988. If the Commission is only able to address accounting violations six years after the fact, its procedures are not likely to have much deterrent effect.

[16] Notice ¶¶ 17-29.

[17] Id. ¶¶ 30-31.

should come to grips with this fact and rely instead on the only proven means of preventing anticompetitive abuse -- structural separation.

CEI, CPNI, network disclosure, and reporting requirements. The BOCs correctly describe CEI as providing competing enhanced service providers ("ESPs") with comparable access to the basic network services used by a BOC for its own enhanced service operations.[18] They also correctly note that, in Computer III, the Commission believed that the CEI requirements would deter access discrimination by the BOCs.[19] The Ninth Circuit, however, has specifically found that CEI is ineffective in preventing such abuse.[20]

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[18] See BellSouth Comments at 13-14.

[19] Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), 104 F.C.C.2d 958 (1986) [hereinafter "Computer III Phase I Order"], on recon., 2 FCC Rcd 3035 (1987) [hereinafter "Computer III Phase II Order"], on further recon., 3 FCC Rcd 1135 (1988), on second further recon., 4 FCC Rcd 5927 (1989), vacated sub nom. California v. FCC, 905 F.2d 1217 (9th Cir. 1990).

[20] The Ninth Circuit noted the inadequacies of CEI in the context of the Georgia MemoryCall case. See California III, 39 F.3d at 930; see also ITAA Comments at 15-19. BellSouth has attempted to revisit the findings of the Georgia Public Service Commission ("PSC") in the MemoryCall case. See BellSouth Comments at 32-50. BellSouth contends that there were no anticompetitive abuses in the MemoryCall case and even suggests that the Georgia PSC's decision in MemoryCall was influenced by other disputes. See id. at 50 n.60. The Commission is not in a position to second guess the findings of a state regulator that, like the Commission itself, performs its functions to the best of its ability in the public interest. ITAA does note that the MemoryCall decision was not overturned in court and that BellSouth's discussion of the case ignores many pertinent issues. A full discussion of BellSouth's anticompetitive conduct in the MemoryCall case has been presented by Cox Enterprises. See Letter from J.G. Harrington to William F. Caton, CC Docket No. 95-20 (Feb. 28, 1995). The Cox submission unequivocally demonstrates that the Georgia PSC properly found BellSouth to have engaged in significant acts of access discrimination and cross-subsidization.

The reason that CEI is not effective in preventing access discrimination is that it was designed with a limited purpose in mind. Although CEI purports to permit competing enhanced service providers to use the exact same basic service, provisioned in the exact same manner, on an equal basis with the BOCs' enhanced service operations, it does not give competing enhanced service providers access to the "building blocks" of the network. Without access to basic network elements, enhanced service providers cannot freely design and implement their own enhanced services. The Ninth Circuit recognized this distinction, and found CEI to be ineffective without fundamental ONA unbundling.[21]

The customer proprietary network information, network disclosure, and nondiscrimination reports are likewise ineffective in preventing anticompetitive abuse. As fully explained in ITAA's initial comments, these "safeguards" do little to deter access discrimination and actually provide the BOCs with a competitive advantage.[22] These safeguards will continue to be ineffective without fundamental unbundling. As MCI concludes, "CEI, even in conjunction with all of the other antidiscrimination rules -- nondiscrimination reports, network information disclosure rules and customer proprietary network information rules -- is worthless as a substitute safeguard."[23]

ONA. The principal reason the Ninth Circuit vacated the Computer III Remand Order is the Commission's wholesale retreat from fundamental unbundling in ONA.

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[21] California III, 39 F.3d at 930. Of course, ONA has not achieved fundamental unbundling. See infra at pp. 9-12.

[22] See ITAA Comments at 29-34.

[23] MCI Comments at 30.

Nonplussed by the Ninth Circuit's decisions in California II and California III,[24] the BOCs continue to contend that their current ONA plans constitute fundamental unbundling and are sufficient to prevent access discrimination.[25] Significantly, none of the other parties to this proceeding shares that view. Even the BOCs do not all agree on exactly what constitutes fundamental unbundling. For instance, Bell Atlantic contends that fundamental unbundling has been achieved "in terms of unbundled services that ESPs have asked for in order to develop and offer their enhanced services."[26] BellSouth, by contrast, argues that fundamental unbundling is meant to have no specifically definable meaning and is only a comparatively improved level of unbundling.[27] NYNEX, however, candidly acknowledges that the Commission did not require all of the unbundling requested by ESPs,[28] a position with which the Commission itself agrees. As the Commission's ONA order specifically states, fundamental ONA unbundling has become a "long-term, evolutionary process."[29] The user community concurs in that assessment. As the Ad Hoc Committee explains, "the

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[24] See California v. FCC, 4 F.3d 1505 (9th Cir. 1993) ("California II"); California III, 39 F.3d at 930.

[25] See, e.g., Bell Atlantic Comments at 20-25; Pacific and Nevada Bell Comments at 51-67; Southwestern Bell Comments at 26-30.

[26] Bell Atlantic Comments at 22 (emphasis in original). The argument that ESPs have received all of the unbundled services they have requested is contradicted by BellSouth's admission that it was unable to provide eleven sought-after services. See BellSouth Comments at 23.

[27] See id. at 28-29.

[28] NYNEX Comments at 15.

[29] Filing and Review of Open Network Architecture Plans, 5 FCC Rcd 3103, 3105 (1990).

ONA implemented by the Commission is not that upon which the structural separation requirements were intended to be lifted. . . . The BOCs' ONA plans did not fundamentally unbundle network functionalities."[30]

The ONA unbundling that has taken place is insufficient to guard against access discrimination. Moreover, to the extent that the BOCs have engaged in some unbundling, the lack of demand for their ONA services signals that they have not unbundled useful services. LDDS, an interexchange carrier, has correctly evaluated the current state of play with respect to ONA:

> If the ESPs are not making significant use of ONA, then this would suggest that the tariffs as currently written (in structure and price) fail to meet the needs of RBOC competitors. The absence of substantial ESP demand suggests that the RBOCs have been able to manipulate ONA to their own advantage, and that ONA without structural separation is not sufficient.[31]

As ITAA pointed out in its initial comments, the only way for ONA to succeed would be for the Commission to require the BOCs to unbundle all of the network building blocks needed by ESPs to design their services and to require the BOCs to price ONA services the same as non-ONA access services.[32] The Commission has chosen to do neither.

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[30] Ad Hoc Comments at 17.

[31] LDDS Comments at 9.

[32] ITAA Comments at 26-28. Not only do the Commission's access charge rules price ONA services beyond the economic reach of independent ESPs, the BOCs themselves price ONA effectively in secret. Because the Commission has permitted the BOCs to restrict access to the cost justification for ONA rates, it is impossible for third parties to evaluate whether the rates are just and reasonable. See Communications Daily, at 5 (Apr. 21, 1995).

If some of the BOCs believe that fundamental unbundling means providing ESPs with the services they need to design their own enhanced services, this criterion has not been met. ESPs are still waiting for the ONA they requested over seven years ago. The Ninth Circuit recognized the significance of the Commission's retreat from true ONA and the necessity for fundamental unbundling before structural separation can be lifted. No party has explained how ONA has been improved, nor how its original promise has been fulfilled, in the years following the Computer III Remand Order. Structural separation should therefore be maintained.

Other Unbundling Proceedings. The BOCs argue that the Commission's actions in the Expanded Interconnection and Intelligent Networks proceedings have achieved unbundling of the network beyond that required by ONA. Although the Commission has made some progress in unbundling the network in the Expanded Interconnection rulemaking, that proceeding "does not provide access to the types of network services most useful to ESPs. An ESP does not have increased access to switching, signalling, or other network control functions."[33] Nor has that proceeding given ESPs the right to insist upon the physical or virtual collocation of their enhanced services equipment in BOC central offices.[34] Although the Expanded Interconnection proceeding represents commendable progress, it does not require sufficient unbundling to safeguard against BOC abuses.

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[33] NAA Comments at 14.

[34] ITAA recognizes that the Court of Appeals has limited the Commission's authority to order physical collocation. The Commission, however, could prohibit the BOCs from providing their own enhanced service operations with physical collocation unless they provided the same access to competing enhanced service providers.

As concerns the proposals in the Intelligent Networks proceeding, they are just that; they have not been implemented by the Commission. MCI and the Newspaper Association of America correctly point out that the Commission may not properly consider nonexistent rules in evaluating the efficacy of nonstructural safeguards.[35] But even if the Commission were to adopt an order in the Intelligent Networks docket, it is unclear whether independent ESPs will be accorded the same access to databases as the BOCs' own enhanced service operations.[36] Unequal access is not the hallmark of an effective safeguard.

Improvements in technology will not, in and of itself, bring about equal access to the local exchange network. As MCI explains,

> the development of new technologies not only has failed to bring about more unbundling but has also made ESPs and other competitive service providers more vulnerable to abuses of the BOCs' monopoly power. The increasing complexity of the network resulting from the deployment of advanced technology makes it more feasible for the BOCs to use their control over signalling to discriminate against competitors . . . .[37]

The Commission needs to weigh this risk in its cost-benefit analysis.

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[35] MCI Comments at 33; NAA Comments at 15.

[36] See ITAA Comments at 35-36.

[37] MCI Comments at 33.

C. The Comments Demonstrate That Market Forces Have Not, and Will Not, Prevent Anticompetitive Abuse.

In their comments, the BOCs contend that the competitiveness of enhanced services markets is sufficient to prevent anticompetitive abuse.[38] The relationship between competitive markets and anticompetitive behavior is important. The BOCs, however, have not distinguished adequately between competition in local exchange markets and competition in enhanced services markets. The fundamental lack of competition in local exchange markets gives the BOCs the ability to leverage their monopolies anticompetitively in enhanced services markets. The state of competition in the enhanced services marketplace is irrelevant to the prevention of anticompetitive abuse. Indeed, the more competitive enhanced services markets are, the greater the incentive for the BOCs to act anticompetitively.

Local exchange services. Regardless of the many predictions of a highly competitive future, it is impossible to conclude that the BOCs have other than a complete stranglehold on local exchange service. The BOCs account for over 99 percent of the local exchange market in their respective territories. As the Hatfield Report points out, competitive access providers bypass only a fraction of the BOCs' customers and only offer certain types of services.[39] Wireless service providers are not price competitive with the BOCs and do not provide the quality of service needed by many enhanced service providers. The provision of local exchange service by cable companies and interexchange carriers is not yet a reality. At present, and for the foreseeable future, virtually all local exchange

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[38] See, e.g., Pacific and Nevada Bell Comments at 7-17; NYNEX Comments at 19-26.

[39] See Hatfield Associates, Inc., "ONA: A Promise Not Realized -- Reprise," CC Docket No. 95-20 (Apr. 6, 1995) at 4-9.

customers have only one real option -- the BOCs. As long as the BOCs possess market power in the provision of local exchange service, they will be able to use that power to act anticompetitively in the enhanced services marketplace.

Although ITAA waits with anticipation for real local exchange competition, and encourages the Commission and the states to adopt policies that will speed the arrival of such competition, any policy decision in this proceeding that is based on the promise of future competition will be inherently flawed. Independent enhanced service providers must compete with the BOCs' enhanced services operations in the present, noncompetitive world. If the Commission does not maintain proven, effective structural separation measures to prevent BOC abuses, competition will be harmed, ratepayers will subsidize unregulated BOC operations, and consumer welfare will be reduced. The time to examine the implications of real local exchange competition will come, and the Commission should deal with the implications of such competition when it actually exists. Until then, the Commission should base its policy decisions on the current state of affairs.

Enhanced services. The BOCs make much of the fact that certain enhanced services markets are competitive.[40] They contend that the existence of competition and non-BOC competitors indicates that anticompetitive behavior is not harming competition. Their analysis, however, is fundamentally flawed. For anticompetitive behavior to be harmful, it need not drive all competitors from the market. The effects are more subtle, yet significant to competing ESPs, ratepayers, and consumers.

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[40] See, e.g., Southwestern Bell Comments at 18-25.

Anticompetitive behavior can cause serious harms in what might otherwise look like a fully competitive market. The Hatfield Reply demonstrates harms caused by anticompetitive behavior that are independent of the competitiveness of the market.[41] Cross-subsidization can permit a less efficient service provider, such as a BOC, to take business from a more efficient service provider that does not have access to monopoly rents. Ratepayers are forced to pay for the cost of the less efficient service offering.[42] Access discrimination may also be successful in driving some competitors out of some businesses. Although other competitors might still remain in those markets, competition is harmed by the absence of additional competitors.[43] Consumers are harmed when access discrimination forces them to accept lower quality or less efficient services because of anticompetitive behavior.[44] Certain types of access discrimination may also slow the introduction of new services. The lost consumer welfare of such delays can be significant, as the BOCs themselves contend.[45] All of these costs of anticompetitive behavior are borne by the public, regardless of the state of competition in the enhanced services marketplace.[46]

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[41] See Hatfield Associates, Inc., "The Benefits of Structural Separation: Reply" at 5-7 [hereinafter "Hatfield Reply"]. The Hatfield Reply has been filed separately with the Commission. See Letter from Brian T. Ashby to William F. Caton (May 19, 1995).

[42] Id. at 7.

[43] Id. at 4-5.

[44] Id. at 7.

[45] See Hausman/Tardiff Report at 10-12.

[46] In fact, the BOCs might be less likely to act anticompetitively if enhanced services markets were not competitive. If the BOCs held dominant market positions in the provision of enhanced services, they would not have as great an incentive to harm

(continued...)

III. THE DOCUMENTED COSTS OF ANTICOMPETITIVE BEHAVIOR SIGNIFICANTLY OUTWEIGH THE UNPROVEN COSTS OF STRUCTURAL SEPARATION.

As discussed above, the Commission's nonstructural safeguards have proven to be ineffective in preventing anticompetitive behavior on the part of the BOCs in the provision of enhanced services. In both the Computer II and Computer III proceedings, the Commission recognized the importance of preventing such anticompetitive abuse. The costs of such anticompetitive conduct, however, are difficult to quantify because of the impossibility of identifying all instances of such behavior. Although difficult to identify and quantify, the harms are very real and cannot be ignored by the Commission. Although the BOCs have attempted to quantify the benefits of the integrated provision of basic and enhanced services, their conclusions are largely guesstimates and the product of tortured logic. Although it may be difficult to place a precise dollar figure on the costs and benefits of structural and nonstructural safeguards, the Commission should err on the side of protecting competition if there is any question as to which costs outweigh the other. In this regard, the Commission need only look to its experience with basic interexchange services. While there may have been "efficiencies" in the integrated provision of interexchange and local services under the old Bell System, the costs of the Bell System's anticompetitive actions clearly outweighed any benefits of integration.

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[46](...continued)
their competitors. Thus, a vigorously competitive market should be viewed as an impetus, not a restraint, on anticompetitive behavior.